

Office of Chief Counsel  
Internal Revenue Service  
**Memorandum**

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CC:SB:4:CHI:1

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subject: Year to deduct theft loss

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer	=
A	=
C	=
D	=
E	=
Year 1	=
Year 2	=
Year 3	=
Year 4	=
Year 5	=
Date X	=
Agency	=
Month Y	=
Month Z	=
a	=

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2

b =

f =

g =

Allegation 1 =

Allegation 2 =

### ISSUE

What year is the proper year of discovery for Taxpayer's theft loss claim under Revenue Procedure 2009-20, as modified by Revenue Procedure 2011-58, where there are multiple lead figures and one lead figure dies before being criminally charged and another lead figure is criminally charged in a later year?

## CONCLUSION

Based on the facts provided, the proper discovery year for Taxpayer's theft loss is Year 4, the year in which: a. the civil complaint was filed by the Agency that alleged facts that comprise substantially all of the elements of a specified fraudulent arrangement conducted by the lead figures; b. one of the lead figures died before being criminally charged; and c. a receiver was appointed with respect to the arrangement.

## FACTS

In Year 2, Taxpayer wrote a check payable to D for \$a to purchase four f. In Year 3, Taxpayer wrote two checks payable to E totaling \$b to purchase additional f. One lead figure, A, was the owner or part owner of several companies, including C.

During Year 4, the Agency was trying to contact A as a result of several complaints they had received. A died in Month Y Year 4. On Date X, the Agency filed a civil complaint against the lead figures, including the estate of A, as well as several related companies the lead figures owned and controlled. The civil complaint alleged that the lead figures engaged in \_\_\_\_\_ from Year 1 through Month Z Year 4.

Taxpayer invested in the \_\_\_\_\_, in which the lead figures offered investors f through D and C. The Agency complaint also alleged that Allegation 1. Based on these allegations, the Agency asserted several violations \_\_\_\_\_.

The Agency moved in court for the appointment of a receiver. A receiver was appointed in Year 4 to recoup money and any other assets from the lead figures and the entities they owned, operated or controlled.

During Year 5, another lead figure was \_\_\_\_\_

Taxpayer claimed a theft loss in Year 4 using Rev. Proc. 2011-58. Exam has asked for advice on whether the year of discovery under Rev. Proc. 2011-58 is Year 4, when one lead figure died, a civil complaint was filed by the Agency, and a receiver was appointed, or Year 5, when criminal charges were filed against another lead figure.

## LAW AND ANALYSIS

Section 165(a) of the Internal Revenue Code allows a deduction for losses sustained during the taxable year and not compensated by insurance or otherwise. A loss arising from criminal fraud or embezzlement in a transaction entered into for profit is a theft loss, not a capital loss, under § 165. Rev. Rul. 2009-9, 2009-14 I.R.B. 735.

Section 165(e) states that any loss arising from theft shall be treated as sustained in the \_\_\_\_\_

taxable year the taxpayer discovers the loss. Under §§ 1.165-8(a)(2) and 1.165-1(d), however, if, in the year of discovery, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss for which reimbursement may be received is sustained until the taxable year in which it can be ascertained with reasonable certainty whether or not the reimbursement will be received. Whether a reasonable prospect of recovery exists is a question of fact to be determined upon examination of all facts and circumstances.

#### Revenue Procedure 2009-20

Rev. Proc. 2009-20, 2009-1 C.B. 749, provides an optional safe harbor treatment for taxpayers that experienced losses in certain investment arrangements discovered to be criminally fraudulent (so-called “Ponzi” schemes). The procedure provides investors with uniform and simplified methods for determining the timing and amount of a theft loss deduction. Rev. Proc. 2009-20 applies to losses for which the discovery year, as defined in § 4.04 of Rev. Proc. 2009-20, is a taxable year beginning after December 31, 2007.

Section 4.03 of Rev. Proc. 2009-20 defines a qualified investor as a United States person, as defined in § 7702(a)(30) --

- (1) That generally qualifies to deduct theft losses under § 165 and § 1.165-8;
- (2) That did not have actual knowledge of the fraudulent nature of the investment arrangement prior to it becoming known to the general public;
- (3) With respect to which the specified fraudulent arrangement is not a tax shelter, as defined in § 6662(d)(2)(C)(ii); and
- (4) That transferred cash or property to a specified fraudulent arrangement. A qualified investor does not include a person that invested solely in a fund or other entity (separate from the investor for federal income tax purposes) that invested in the specified fraudulent arrangement. However, the fund or entity itself may be a qualified investor within the scope of the revenue procedure.

Section 4.01 of Rev. Proc. 2009-20 defines a specified fraudulent arrangement as an arrangement in which a party (the lead figure) receives cash or property from investors; purports to earn income for the investors; reports income amounts to the investors that are partially or wholly fictitious; makes payments, if any, of purported income or principal to some investors from amounts that other investors invested in the fraudulent arrangement; and appropriates some or all of the investors' cash or property.

Section 4.02 of Rev. Proc. 2009-20 defines a qualified loss as a loss resulting from a specified fraudulent arrangement in which, as a result of the conduct that caused the loss --

- (1) The lead figure (or one of the lead figures, if more than one) was charged by indictment or information (not withdrawn or dismissed) under state or federal law with the commission of fraud, embezzlement or a similar crime that, if proven, would meet the definition of theft for purposes of § 165 and § 1.165-8(d), under the law of the jurisdiction in which the theft occurred; or
- (2) The lead figure was the subject of a state or federal criminal complaint (not withdrawn or dismissed) alleging the commission of a crime described in section 4.02(1) of this revenue procedure, and either --
- (a) The complaint alleged an admission by the lead figure, or the execution of an affidavit by that person admitting the crime; or
- (b) A receiver or trustee was appointed with respect to the arrangement or assets of the arrangement were frozen.

Section 4.04 of Rev. Proc. 2009-20 states that a qualified investor's discovery year is the taxable year of the investor in which the indictment, information, or complaint described in the definition of qualified loss under § 4.02 is filed.

#### Revenue Procedure 2011-58

The Service and Treasury issued Rev. Proc. 2011-58 to address situations in which the death of lead figures in certain Ponzi schemes prevented government authorities from charging them with criminal theft. Rev. Proc. 2011-58, 2011-2 C.B. 849, modified the definition of a qualified loss in Rev. Proc. 2009-20 to include the situation in which the lead figure or an associated entity involved in the specified fraudulent arrangement was the subject of one or more civil complaints or similar documents (such as a notice or order instituting administrative proceedings or other document the Internal Revenue Service designates) filed by a state or federal governmental entity with a court or in an administrative agency enforcement proceeding, and all of the following requirements are satisfied:

- (a) The civil complaint or similar documents together allege facts that comprise substantially all of the elements of a specified fraudulent arrangement conducted by the lead figure;
- (b) The death of the lead figure precludes a criminal charge by indictment, information or criminal complaint against that lead figure; and
- (c) A receiver or trustee was appointed with respect to the arrangement or the assets of the arrangement were frozen.

Section 4.02(3) of Rev. Proc. 2011-58.

In addition, section 4.02 of the revenue procedure modified the definition of discovery year in section 4.04 of Rev. Proc. 2009-20 to include the later of either the year in which the civil complaint or similar document which alleges facts that comprise substantially all the elements of a specified fraudulent arrangement is filed, or the year in which the lead figure dies.

In the instant case, the year of discovery is Year 4 when: a. the civil complaint was filed by the Agency that alleged facts that comprise substantially all of the elements of a specified fraudulent arrangement conducted by the lead figures; b. one of the lead figures died before being criminally charged; and c. a receiver was appointed with respect to the arrangement.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 317-7011 if you have any further questions.